EBA/RTS/2017/01

09 February 2017

EBA Final Draft Regulatory Technical Standards

On the procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for credit valuation adjustment risk under Article 382(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

Contents

1. Executive summary

Article 382(4)(a) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) excludes from the own funds requirements for credit valuation adjustment (CVA) risk an institution's transactions with non-financial counterparties (NFCs), regardless of whether these NFCs are established in the EU or in a third country, where those transactions do not exceed the clearing threshold specified in Article 10(3) and (4) of Regulation (EU) No 648/2012 (European Markets Infrastructure Regulation – EMIR) (in this situation, the NFC is referred to as 'NFC–'). As a result, an institution's transactions with an NFC are excluded when the NFC is NFC– according to EMIR or would qualify as NFC– if it were established in the EU.

Article 382(4)(a) of the CRR requires, for the specific case of NFCs established in a third country, that the clearing threshold specified in EMIR be taken into consideration in order for transactions with NFCs established in a third country to be excluded from the CVA risk charge.

The EBA is mandated to develop, in cooperation with the European Securities and Markets Authority (ESMA), regulatory technical standards (RTS) to specify the procedures for excluding transactions with NFCs established in a third country from the own funds requirements for CVA risk.

These proposed draft RTS further clarify that the institution itself is responsible for taking the necessary steps to identify all NFCs that qualify for the exemption under Article 382(4)(a) of the CRR and calculate their own funds requirements for CVA risk accordingly[1].

In particular, these proposed draft RTS specify that the institution should ensure that:

- those of its counterparties established in a third country that are subject to the exemption under Article 382(4)(a) of the CRR would qualify as a NFC if they were established in the EU;
- the notional value of all the over-the-counter (OTC) derivative transactions of those NFCs do not exceed the clearing threshold specified in Article 10(3) and (4) of EMIR.

The last subparagraph of Article 382(4) of the CRR clarifies that, where the clearing threshold is exceeded at some particular point in time, outstanding contracts at that time remain exempt until the date of their maturity. This therefore makes it sufficient for an institution to meet the requirements of these RTS at trade inception only. However, as such a requirement on institutions could be disproportionate in cases where an institution frequently enters into trades with an NFC established in a third country, the EBA proposes that, in addition to the option of carrying out the verification of the status of the counterparty at trade inception, verification of the status may instead be performed periodically for each counterparty.

[1] This is consistent with EBA Q&A 2013_472, which can be found at http://www.eba.europa.eu/single-rule-book-qa.

2. Background and rationale

In December 2010, the Basel Committee on Banking Supervision (BCBS) published *A global regulatory framework for more resilient banks and banking systems*, commonly known as Basel III, which aimed to address the lessons drawn from the financial crisis. In reaction to CVA losses suffered during the crisis, the Basel III standards introduced a capital charge against CVA risk[2].

The CRR implements in the EU the BCBS requirements to compute own funds requirements for CVA risk. The scope of application of the CVA risk charge, however, has been limited in the EU owing to the inclusion of specific exemptions aimed at addressing concerns about unintended effects of the Basel CVA framework. Specifically, the CRR excludes from the CVA risk charge transactions with certain financial, non-financial and sovereign counterparties.

According to Article 382(4)(a) of the CRR, transactions with NFCs, where those transactions do not exceed the clearing threshold specified in Article 10(3) and (4) of EMIR, are currently excluded from the own funds requirements for CVA risk, regardless of whether these NFCs are established in the EU or in a third country. In particular, the CRR requires the clearing threshold specified in EMIR to be applied to NFCs established in a third country in order for them to be excluded from the CVA risk charge.

The EBA is mandated to develop, in cooperation with the ESMA, RTS to specify the procedures for excluding transactions with NFCs established in a third country from the own funds requirements for CVA risk. It should be noted that the EBA has already addressed this issue in part, in EBA Q&A 2013_472[3], where the following preliminary answer was given, without prejudice to the approach developed in the present RTS:

The institution itself is responsible for taking the necessary steps to identify all non-financial counterparties that qualify for the exemption under Article 382(4)(a) of the CRR and calculate their own funds requirements for CVA risk with respect to those eligible non-financial counterparties accordingly (regardless of whether they are located within the EU or in a third country). As a result, 'institutions should define appropriate arrangements with non-financial counterparties to ensure they remain informed of their status as regards the clearing threshold on an ongoing basis.

[2] Basel III: A global regulatory framework for more resilient banks and banking systems - revised version June 2011 http://www.bis.org/publ/bcbs189.htm.

[3] This can be found at http://www.eba.europa.eu/single-rule-book-qa.

The EMIR clearing threshold and CRR CVA exemptions

Under EMIR, NFCs aggregate their positions in OTC derivatives and compare them with the clearing threshold using a number of rules, which derive from EMIR and ESMA RTS[4]. In particular, NFCs have to:

- include the positions of all the NFCs of the group (irrespective of the country of establishment);
- aggregate the positions per asset class to compare the results with the five thresholds provided for in ESMA RTS.

In addition, NFCs may exclude from the calculation of the threshold trades conducted for hedging purposes as defined in the RTS[5].

If any of the thresholds is exceeded, the NFC becomes a so-called NFC+ counterparty and is subject to specific requirements, in particular the clearing obligation. The specific requirements are then applicable to all the EU NFCs of the group and to all their future contracts. In particular, the clearing obligation would apply to future contracts concluded for both hedging and non-hedging purposes. Likewise, the clearing obligation would apply to all derivatives from all asset classes even if only one threshold for one asset class was exceeded.

In contrast, Article 382(4)(a) of the CRR excludes from the CVA risk charge transactions with NFCs, where those transactions do not exceed the clearing threshold as specified in Article 10(3) and (4) of EMIR. The drafting of Article 382(4)(a), and in particular the words ‘where those transactions do not exceed the clearing threshold’, could be read as meaning that the positions that are relevant for the purpose of the threshold are either:

- an institution’s transactions with each NFC the institution has non-exempted transactions with, i.e. not taking into account other positions of that NFC with its other counterparties or positions taken by other NFCs of the group; or
- an institution’s transactions with all NFCs the institution has non-exempted transactions with, regardless of whether these NFCs are NFC+ or NFC–, established in the EU or in a third country.

Either reading would lead to a misalignment between EMIR and the CRR, whereas the intention of the EU legislator was to exempt from the CVA risk charge institutions’ transactions with NFC– counterparties regardless of the CVA risk for the institution of these transactions.

Under the first reading, transactions could be excluded from CVA risk even if the NFC were NFC+ for EMIR purposes, provided that the total notional value of transactions between the institution

[4] Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012.

[5] Ibid.

and that NFC+ counterparty was below the clearing threshold. However, it is unlikely that an institution's transactions with an NFC could exceed one of the clearing thresholds, since the clearing thresholds were designed to consider all the derivative transactions, across all counterparties and asset classes, of all the NFCs of a group. This would result in transactions with NFCs being exempt from the CVA risk charge.

Under the second reading, comparing the aggregated amount of all the transactions of an institution with all EU and non-EU NFCs with the EMIR threshold would result in removing the exemption depending on the importance of the derivative business of an institution. This would imply that this EU exemption (and the EMIR threshold) was designed to set out an acceptable level of exempted CVA risk for an institution, whereas in practice the intention was to exempt NFC– counterparties regardless of the institution's CVA risk. More generally, this reading would drastically reduce the relevance of the present RTS, as the aim of these RTS is precisely to specify how NFCs established in a third country should apply the EMIR threshold despite not being subject to EMIR regulation.

Finally, a Corrigendum to the CRR has made the following addition to the last subparagraph of Article 382(4): 'In regard to point (a) [EU NFCs and non-EU NFCs], where an institution ceases to be exempt through [the NFC] crossing the exemption threshold or due to a change in the exemption threshold, outstanding contracts shall remain exempt until the date of their maturity.'

In summary, the EBA considers that the intention behind the cross-references to EMIR was alignment with EMIR as far as the definition of the counterparties in question was concerned and that the clearing threshold would be too high if applied only to transactions between an institution and an NFC. Furthermore, whereas the reference to Article 10(4) of EMIR would have been enough to make the link with the values of the threshold, the CRR Article also refers to Article 10(3) of EMIR, which clearly states that the OTC derivative contracts to be considered are the contracts entered into by the NFC: 'In calculating the positions referred to in paragraph 1, the non-financial counterparty shall include all the OTC derivative contracts entered into by the non-financial counterparty or by other non-financial entities within the group to which the non-financial counterparty belongs, which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.'

As a result, in the context of Article 382(4)(a) of the CRR, transactions of an institution with an NFC are excluded when the NFC is NFC– according to EMIR or would qualify as NFC– if it were established in the EU.

NFCs established in a third country in the CVA Report and Review

The EBA assessed separately the issue of NFCs established in a third country in the CVA Report[6]. As shown by Figures 19 and 20 of the CVA Report, the non-EU NFC exemption represents the

[6] https://www.eba.europa.eu/documents/10180/950548/EBA+Report+on+CVA.pdf

greatest impact in terms of Common Equity Tier 1 ratio for one bank on the panel. In addition, its impact is non-negligible for other banks on the panel. On average, it is the most material exemption after EU NFCs and sovereigns. As shown by Figure 21 of the CVA Report, banks still have operational difficulties in identifying the non-EU NFCs that are exempted from the CVA risk charge according to Article 382(4a) of the CRR: this is the case for 9 respondents out of 24. It makes this type of exemption, together with the exemption of EU NFCs, the most difficult to apply. Half of the respondents seem to remove these counterparties automatically, whereas the other half remove them manually or both automatically and manually.

In the CVA Report[7], the EBA concludes that, provided that the definition of the NFC exemption from the CVA risk charge remains based on the EMIR clearing threshold, there are no strong reasons from a technical point of view why this approach should fundamentally differ for NFCs established in a third country. As a result, the EBA recommends applying a similar approach to that applied to NFCs established in the EU, until EU exemptions are more globally reconsidered.

However, acknowledging that there are specifics to be taken into account when excluding NFCs established in a third country, the EBA, in cooperation with ESMA, is specifying in these RTS the procedures for excluding transactions with NFCs established in a third country.

[7] See Section 6 of the CVA Report.

3. EBA final draft Regulatory Technical Standards on the procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for credit valuation adjustment risk under Article 382(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)

EUROPEAN
COMMISSION

Brussels, XXX
[…](2015) XXX draft

COMMISSION DELEGATED REGULATION (EU) No …/..

of XXX

supplementing Regulation (EU) 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for credit valuation adjustment risk

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [8], and in particular the fourth subparagraph of Article 382(5) thereof,

Whereas:

(1) Pursuant to point (a) of Article 382(4) of Regulation (EU) No 575/2013, transactions between an institution and a non-financial counterparty as defined in point (9) of Article 2 of Regulation (EU) No 648/2012, where those transactions do not exceed the clearing threshold referred to in Article 10(3) and Article 10(4) of Regulation (EU) No 648/2012[9], are excluded from the own funds requirements for credit valuation adjustment (CVA) risk irrespective of whether that non-financial counterparty is established in the Union or in a third country.

(2) Point (9) of Article 2 of Regulation (EU) No 648/2012 defines a ‘non-financial counterparty’ with reference to undertakings established in the Union. As a result, the clearing threshold referred to in Article 10(3) and Article 10(4) of that Regulation does not apply to non-financial counterparties established in a third country. It is therefore necessary to define procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirements for CVA risk. To ensure a level playing field, the same rules should apply to non-financial counterparties established in the Union and non-financial counterparties established in a third country.

(3) Article 10 of Regulation (EU) No 648/2012 provides that non-financial counterparties need to compute their total positions in over-the-counter (OTC) derivative contracts and to compare the result of that computation with the threshold, to determine whether it exceeds the threshold value. Article 11 of Regulation (EU) No 149/2013 sets out clearing threshold values per class of OTC derivatives, as required by point (b) of Article 10(4) of Regulation (EU) No 648/2012. Recital 25 of Regulation (EU) No 149/2013 clarifies that the ‘excess of one of the values set for a class of OTC derivatives should trigger the excess of the clearing threshold for all classes’. To ensure a level playing field, the same rules should apply to non-financial counterparties established in a third country.

(4) For a contract to be exempt until the date of its maturity, it should be sufficient, as laid down in the last subparagraph of Article 382(4) of Regulation (EU) No 575/2013, that the requirements of this Regulation are met at contract inception. There might be cases, however, where an institution enters into trades with a given non-financial counterparty very frequently, and in some cases, on a daily basis.

[8] OJ L 176, 27.6.2013, p. 338.

[9] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012 p. 1).

Verification of whether the status of the non-financial counterparty established in a third country is accurately reflected in the institution's own funds requirements for CVA risk may in those cases impose a disproportionate burden on the institution. It is therefore appropriate to provide for an alternative in the form of an annual verification of the status of the non-financial counterparty established in a third country. The frequency of verification should be increased to quarterly, however, where the gross notional amount of transactions for a class of OTC derivatives by a non-financial counterparty is close to exceeding the clearing threshold for that class. This should allow for more frequent monitoring of whether this clearing threshold has been exceeded, given the higher likelihood that this will be the case.

(5) Article 382(4) of Regulation (EU) No 575/2013 sets out the conditions for exempting transactions from the CVA risk charge: those are the qualification of a counterparty as a non-financial counterparty, and the compliance of that counterparty with the clearing threshold. Therefore, where, following the assessment set out in this Regulation, an institution discovers that one of its counterparties established in a third country either does not qualify as a non-financial counterparty, or exceeds the clearing threshold as specified in this Regulation, the institution is required to compute own funds requirements for CVA risk in accordance with Title VI of Regulation (EU) No 575/2013 for all OTC derivative instruments with that counterparty that fall within the scope of Article 382(1) of that Regulation.

(6) This Regulation is based on the draft regulatory technical standards developed in cooperation with the European Securities and Markets Authority and submitted by the European Banking Authority to the Commission.

(7) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010[10].

HAS ADOPTED THIS REGULATION:

Article 1

Qualification as a non-financial counterparty established in a third country

For the purposes of point (a) of Article 382(4) of Regulation (EU) No 575/2013, institutions shall consider as non-financial counterparties established in a third country counterparties that meet both of the following conditions:

(a) they are established in a third country;

(b) they would qualify as a non-financial counterparty within the meaning of point (9) of Article 2 of Regulation (EU) No 648/2012 if they were established in the Union.

[10] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Article 2

Qualification as a non-financial counterparty established in a third country below the EMIR clearing threshold

For the purpose of excluding transactions with a non-financial counterparty established in a third country from the own funds requirements for CVA risk, institutions shall verify, for each class of OTC derivatives referred to in Article 11 of Regulation (EU) No 149/2013, that the gross notional value of the OTC derivative contracts of that counterparty within the class does not exceed the relevant clearing threshold referred to in Article 11 of that Regulation.

Article 3

Procedures for confirming compliance with regulatory requirements

1. Institutions shall carry out the verification referred to in Articles 1 and 2 for each counterparty at either of the following points:

(a) at the inception of each new trade with that counterparty;

(b) on a periodic basis.

2. For the purpose of point (b) of paragraph 1, the verification shall be performed with either of the following frequencies:

(a) on an annual basis;

(b) on a quarterly basis, where for any of the classes of OTC derivatives the gross notional value of OTC derivatives transactions of the non-financial counterparty established in a third country is greater than 75% of the clearing threshold value for that class referred to in Article 11 of Regulation (EU) No 149/2013.

3. Institutions shall base their decision on internal or publicly available information, as well as any other information submitted by counterparties, and shall document their decision and its rationale.

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

4. Accompanying documents

4.1 Draft cost-benefit analysis/impact assessment

Article 10(1) of the EBA Regulation provides that when any regulatory technical standards (RTS) developed by the EBA are submitted to the Commission for adoption, they should be accompanied by an analysis of 'the potential related costs and benefits'. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

A. Problem identification

During the crisis, CVA losses occurred as a result of the global deterioration of the credit quality of participants in the derivative markets. It appeared that institutions' own funds requirements did not adequately reflect all risks stemming from derivative transactions. The CVA risk charge was intended to remedy this problem. While the revised Basel framework envisaged a comprehensive consideration of those derivative-related counterparty risks, the EU implementation (CRD IV/CRR) facilitated the exclusion of transactions with NFCs from the calculation of the CVA risk charge.

EMIR allows for the identification of NFCs established in the EU. However, the procedure for the identification of NFCs established in a third country is not specified, as NFCs established in a third country are not covered by EMIR. This results in a lack of clarity for the purposes of applying the CVA exemption, which could – and effectively does[11] – lead to different practices and outcomes across Member States. Potentially, it could also result in transactions with EU and non-EU NFCs being treated differently. Obviously, such a difference in the treatment of NFCs could hardly be justified from a risk management or prudential supervision perspective.

B. Policy objectives[12]

At a high level, these RTS are expected to contribute to the general objectives of stability of the banking system and a high, effective and consistent level of banking regulation across the EU.

More specifically, these RTS should ensure consistency in the calculation of capital requirements for EU institutions.

At the operational level, these RTS aim to specify the procedures for excluding transactions with NFCs established in a third country from the calculation of the CVA risk charge.

[11] EBA report on credit valuation adjustment and review on the application of CVA charges to non-financial counterparties established in a third country (2015).

[12] European Commission, Impact assessment accompanying the Regulation on prudential requirements for credit institutions and investment firms (2011).

C. Baseline scenario

Under the baseline scenario, the problems identified above – in particular the lack of clarity on the procedure for identification of NFCs established in third countries and, as a consequence, different practices and outcomes across Member States – would persist.

D. Options considered

As the development of these RTS follows from the CRR mandate referred to above, the options considered in the Consultation Paper (CP) concerned only technical specifications of the concrete procedure for excluding transactions with NFCs established in a third country from the own funds requirement for CVA risk.

More precisely, the CP RTS suggested specifying either of the following:

(i) the verification of the status of the counterparty performed by institutions for exempting NFCs established in third countries should be carried out at trade inception (Option A); or

(ii) the verification of the status of the counterparty performed by institutions for exempting NFCs established in third countries should be carried out at a minimum frequency, irrespective of any inception of a new trade (Option B).

E. Cost-benefit analysis

When the clearing threshold is being exceeded by an NFC– counterparty, contracts of an institution with this NFC that are outstanding at that time remain exempt until the date of their maturity. As a result, ensuring at trade inception that the NFC established in a third country qualifies as an NFC and as NFC– is generally deemed sufficient to meet the requirements for this trade to be exempt until the date of its maturity (Option A). At the same time, this requirement would ensure that, before entering into any new transaction, the situation of the NFC would have been reassessed in order to avoid any non-compliance issue. The objectives of consistency in the calculation of own funds requirements and supervisory convergence across the EU would be efficiently achieved. The cost of performing their due diligence requirements for exempting NFCs established in third countries at trade inception could, nevertheless, be significant for institutions that frequently enter into new trades with NFCs established in third countries.

Therefore, it may be more appropriate, where an institution frequently enters into trades with a given NFC, to require the institution to perform the verification set out in these RTS at a minimum frequency, rather than at the inception of each trade. In this case, institutions would be required to ensure 'on a periodic basis' that an NFC established in a third country would qualify as NFC– under EMIR (Option B). It should be stressed, however, that the introduction of a minimum frequency would require institutions to perform the verification at this minimum frequency even in the absence of a new trade. The cost for institutions of performing their due diligence requirements could be lower for some institutions, with benefits in terms of consistency in the calculation of capital requirements and convergence of supervisory practices achieved to almost the same degree as under Option A.

In both cases, the due diligence costs would be largely balanced out by the capital relief for institutions that is expected to result from the CVA exemption.

F. Preferred option

Given the greater relevance of the assessment at trade inception of whether an NFC established in a third country qualifies as an NFC and as NFC–, the requirement to assess third country NFCs at trade inception was considered more proportionate in the CP.

Considering the variety of industry views and the fact that no clear preference was expressed for Option A or Option B, the EBA acknowledges that both options could be sensible in different situations and, therefore, includes in Article 3 the option for institutions to carry out the relevant due diligence for each counterparty either at trade inception or periodically. Where the due diligence exercise is performed periodically, it should be done at least annually or, where the notional value of OTC derivative transactions of an NFC is close to the EMIR threshold (i.e. greater than 75% of the clearing threshold values), at least quarterly.

Such a combination of Options A and B should in any case result in a lesser burden than the options presented as part of the CP.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 5 November 2015. Seven responses were received, of which four were published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments, and the actions taken to address them if deemed necessary.

In many cases several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments, and the EBA's analysis, are included in the section of this paper where the EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

Some respondents highlighted the fact that many third country NFCs only transact with EU counterparties on an occasional basis and tend to show reluctance in stating their status with respect to foreign legislation. In this regard, the EBA is of the view that, should a third country NFC be reluctant to give information or should this lead to the impossibility of concluding that the counterparty would be NFC– if it were established in the EU, then the institution should simply compute a CVA risk charge for all the transactions with that counterparty. In a way, not exempting NFCs established in a third country re-establishes a level-playing field between EU banks and banks in non-EU jurisdictions, which do not benefit from the CRR exemption.

Several respondents suggested allowing the use of publicly available information and any other information submitted by the counterparty not only for classifying the counterparty as NFC but also for determining whether the NFC is NFC–. The EBA agrees that institutions should be allowed to include in the assessment made under these RTS 'internal or publicly available information, as well as any other information submitted by counterparties'. In particular, the EMIR NFC Representation Protocol could form part of the information guiding institutions' assessments.

Finally, considering the variety of industry views and the fact that no clear preference was expressed for Option A or Option B, the EBA includes in Article 3 the option for institutions to carry out due diligence for each counterparty either at trade inception or periodically. Due diligence should be performed annually, or quarterly where the NFC is close to the EMIR threshold (i.e. the notional value of its OTC derivative transactions is greater than 75% of the clearing threshold values).

Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Qualification as an NFC	One respondent points out that many third country NFCs only transact with EU counterparties on an occasional basis and tend to show reluctance in stating on an ongoing basis their status with respect to foreign legislation. In addition, many transactions are taken through the non-EU subsidiary of the EU banking group, and local counterparties consider these transactions (which are not in the direct scope of EMIR) as fully local. This respondent is of the opinion that the RTS should implicitly recognise that obtaining the counterparty's EMIR status is more difficult in these cases and should implement a workable procedure to offer these counterparties fair treatment and prevent disruption of domestic third country markets. Several respondents propose broadening the scope of Article 1 and allowing publicly available information and any other information submitted by the counterparty not only for classifying the counterparty as NFC but also for determining whether transactions are subject to the CVA risk charge.	Considering the scope of application of the CVA risk charge in the EU, which is limited owing to the inclusion of exemptions, the impossibility of concluding that an NFC established in a third country would qualify as NFC– if it were in the EU would simply lead to the computation of a CVA risk charge for the transactions with that NFC, which may be a requirement for banks established in that third country, should they be subject to Basel requirements. In other words, the EBA does not consider that these RTS could result in the unfair treatment of an NFC established in a third country or in any disruption of third country markets. In the worst case, not exempting NFCs established outside the EU would re-establish a level-playing field between EU banks and banks in non-EU jurisdictions, which do not benefit from the CRR exemption. Following feedback from the industry, the RTS have been amended to specify more clearly that institutions can rely on 'internal or publicly available information, as well as any other information submitted by counterparties'.	Amendment to Articles 1 and 3.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Calculation of positions in OTC derivative contracts for the purposes of the EMIR clearing threshold	Several respondents highlight that the proposed requirement for EU banks to 'ensure and document' that NFCs calculate their positions in OTC derivatives goes beyond ESMA's EMIR guidance, which states that the EU counterparty is not expected to conduct verifications of the representations received from the third country entity. One respondent points out that it is impossible for an EU financial corporation to verify the accuracy of the calculations regarding the clearing threshold made by the third country NFC, as the EU financial counterparty would not have access to this data. Several respondents point out that an alignment is needed between the mechanisms according to which the counterparties are classified as NFCs, both in the RTS requirements and in the current approach under EMIR, as well as in the requirements for financial counterparties and NFCs formulated in the EBA Q&A 2013_472 and the ESMA Q&A OTC 4 and 13. One respondent proposes amending Article 2 in the following way: Institutions shall assess, based on the publicly available information and any other information submitted by counterparties, whether a third country entity identified under Article 1 would, if it were established in the Union, qualify as an NFC whose positions in OTC derivative	The CVA exemption should be granted only in cases where the financial counterparty has enough information to assess that the NFC established in a third country would be NFC– if it were established in the EU. If the institution does not have such information, then transactions with that NFC should be subject to a CVA risk charge. Cross-references to EMIR in the CRR have generated consistency issues, which these RTS also address. These final RTS are considered to be consistent with both EMIR and CRR provisions. However, in order to reflect the feedback from the industry, the RTS have been amended to specify more clearly that institutions can rely on 'internal or publicly available information, as well as any other information submitted by counterparties'.	Amendment to Articles 2 and 3.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	contracts do not exceed the clearing threshold as specified under Article 10(3) and (4) of Regulation (EU) No 648/2012. The institution shall keep a record of its determination.		
Responses to questions in Consultation Paper EBA/CP/2015/14			
Question 1. What are stakeholders' views on the proposed interpretation?	Most respondents agree with the EBA's interpretation of the scope of Article 382(4) of the CRR, being that: • All transactions with an NFC– counterparty are excluded from the CVA risk charge regardless of the inception date of the transaction. • Transactions with an NFC– counterparty will not attract a CVA risk charge for the life of the contract even when the NFC– counterparty becomes NFC+. • Only contracts traded with NFC+ counterparties that are not cleared will attract a CVA risk charge. • All non-cleared transactions will no longer be subject to a CVA risk charge when an NFC+ counterparty transitions to NFC–. Several respondents consider that not only transactions with NFC– counterparties but also hedging transactions with all NFCs should be excluded from the own funds requirement for CVA risk, and they ask for clarification on this.	The fact that trades may be conducted by NFCs for hedging purposes is considered only in the computation of the EMIR threshold. This indirectly impacts the CVA risk charge to the extent that a greater share of trades conducted for hedging purposes may lead to the NFC not exceeding the EMIR threshold, and therefore being considered NFC– and exempted from the CVA risk charge. The EBA maintains the proposed interpretation and, regarding transactions entered into for hedging purposes, clarifies that: • Hedging transactions are excluded from the calculation of the clearing threshold (relevant only to determine whether counterparties are NFC+ or NFC–). • Once a counterparty is NFC+, all the transactions that an institution has with that NFC+ counterparty are subject to a CVA risk charge (unless QCCP cleared or otherwise excluded from the scope of the CVA risk charge), irrespective of whether those transactions are for hedging purposes or not.	No change.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 2. What are stakeholders' views on the burden this might create for NFCs established in a third country? What could be a credible alternative treatment?	One respondent states that third country NFCs have been reluctant to give representations regarding their categorisations and have in many cases refused to do it, so that legal exemption is difficult to apply as a result of administrative or formal burdens, especially when the transaction is with a non-EU subsidiary of the EU entity, as none of the parties is subject to EMIR. Therefore, the respondent proposes that EU banking groups should be allowed to use other information that clearly indicates that transactions are excluded from the CVA risk charge. One respondent expresses the view that third country subsidiaries and affiliates of EU firms should be required to determine the status of third country NFCs only should the contract be deemed to have a direct, substantial and foreseeable effect on the EU. In all other cases, the respondent proposes a derogation in which these non-EU NFCs are treated as NFC– for the purpose of the CVA risk charge, unless information demonstrates that the NFC would be NFC+. One respondent is of the view that the RTS should allow the same flexibility for determining the status of an NFC and for determining whether the CVA risk charge should apply as is the current practice under Article 11 of EMIR and Chapter VII of European Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012. One respondent expresses the view that EU firms	Based on the feedback received, the EBA decided to allow institutions to include in the assessment made under Articles 1 and 2 'internal or publicly available information, as well as any other information submitted by counterparties'. In particular, the EMIR NFC Representation Protocol could form part of the information guiding the assessment. However, should a third country NFC be reluctant to give information and should this lead to the impossibility of concluding that the counterparty would be NFC– if it were established in the EU, then, according to recital 5 of this Regulation, the institution should compute a CVA risk charge for all the transactions with that counterparty.	Amendment to Articles 1 and 2.

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	asking for representations from clients should continue to rely on them unless the counterparties inform them of a change of status or unless it is demonstrably obvious that the current representations are incorrect (i.e. on the basis of publicly available information). The firm should be able to make such an assessment at a frequency determined by itself. One respondent believes the options proposed by the EBA would be too burdensome for smaller counterparties and might result in misclassification of NFCs that would increase hedging costs. The respondent therefore proposes applying a simplified approach for NFCs that cannot engage in speculative OTC derivatives trading. For such corporates, the EU banks should be able to take local law, the confirmation of hedging purposes and materiality into account. One respondent believes that, regarding the determination of NFCs in third countries, where requisite information is available publicly, EU banks should be able to rely on this information and no additional representation should be required from the NFC; in particular, the EMIR NFC Representation Protocol could be used.		
Question 3. What are stakeholders' views on the relevance of the inclusion of a specific frequency? What is stakeholders' preferred	One respondent recommends alignment with EMIR to ensure regulatory constituency regarding frequency. One respondent expresses the view that the EU banking groups should be able to use any		

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option?	information available (e.g. local law banning on-hedging OTC derivatives) that clearly indicates that all transactions with an NFC should be excluded from the CVA risk charge and, if such information is not available, any procedure stipulated in the RTS should be demanded only at the inception of a transaction (Option A). One respondent does not consider it appropriate to require firms to repeat their due diligence on counterparties at a specified frequency. Instead, when a firm receives a representation from an NFC, the firm should be able to rely on the representation unless it is in possession of information to the contrary (ESMA Q&A 4 and 13). One respondent points out that it is disproportionate for banks with a high volume of trading with third country NFCs to carry out a due diligence and provide documentation each time a contract is concluded. For institutions with a low volume of trading with third country NFCs, it is disproportionate to carry out the due diligence on a quarterly basis. One respondent believes that if there were a need for more frequent confirmation of the counterparty's status, the status of the NFC– counterparty should be confirmed at the inception of a trade with a new counterparty (Option A). The respondent proposes keeping this status valid for one year for all trades within this period, while after this validity period the NFC– counterparty would have to reconfirm its status at the time of	Considering the variety of industry views and the fact that no clear preference was expressed for Option A or Option B, the EBA, while maintaining a preference for the identification of third country NFC– counterparties at trade inception, acknowledges that both options could be sensible in different situations and, therefore, includes in Article 3 the option for institutions to carry out the relevant due diligence for each counterparty either at trade inception or periodically. Where the due diligence exercise is performed periodically, it should be done at least annually or, where the notional value of OTC derivative transactions of an NFC is close to the EMIR threshold (i.e. greater than 75% of the clearing thresholds values), at least quarterly.	Amendment to Article 3.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	inception of the next new trade. If the NFC+ counterparty became NFC–, the status could, however, be updated outside of the reconfirmation period to avoid waiting for the next trade.		